Accounting for a Sustainable Future™

MULTILINE AND SPECIALTY RETAILERS & DISTRIBUTORS

Research Brief

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MULTILINE AND SPECIALTY RETAILERS & DISTRIBUTORS

Research Brief

SASB's Industry Brief provides evidence for the disclosure topics in the Multiline and Specialty Retailers & Distributors industry. The brief opens with a summary of the industry, including relevant legislative and regulatory trends and sustainability risks and opportunities. Following this, evidence for each disclosure topic (in the categories of Environment, Social Capital, Human Capital, Business Model and Innovation, and Leadership and Governance) is presented. SASB's Industry Brief can be used to understand the data underlying SASB Sustainability Accounting Standards. For accounting metrics and disclosure guidance, please see SASB's Sustainability Accounting Standards. For information about the legal basis for SASB and SASB's standards development process, please see the Conceptual Framework.

SASB identifies the minimum set of disclosure topics likely to constitute material information for companies within a given industry. However, the final determination of materiality is the onus of the company.

Related Documents

- Multiline and Specialty Retailers & Distributors Sustainability Accounting Standards
- Industry Working Group Participants
- SASB Conceptual Framework

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SUSTAINABILITY DISCLOSURE TOPICS

ENVIRONMENT

- Energy Management in Retail & Distribution

SOCIAL CAPITAL

- Data Security

HUMAN CAPITAL

- Workforce Diversity & Inclusion
- Fair Labor Practices

LEADERSHIP AND GOVERNANCE

- Product Sourcing, Packaging, and Marketing

WATCH LIST

- Data Privacy

INTRODUCTION

The Multiline and Specialty Retailers & Distributors industry has evolved and consolidated significantly over the past decades. It has gone from being a mostly decentralized industry with a diverse array of local stores to one in which massive companies offer customers a large variety of goods sourced from around the world. Companies manage their global supply chains to keep costs low while anticipating consumer demands.

The largest companies in this industry wield considerable buying power, which they can use not just to secure low prices but also to ensure product safety, environmental sustainability, and safe labor practices. The rise of the Internet and social media has greatly increased the amount of customer scrutiny on company policies, as well as the speed with which publicity—negative or positive—can spread. Customers now expect greater transparency and sustainability considerations in company operations and supply chains.

Furthermore, the industry's low margins and fierce competition have compelled some companies to search for ways to cut long-term overhead, spurring innovations in the energy efficiency of retail spaces. Recently this industry has been the target of many high-profile customer data breaches. Companies need to have robust response systems for these attacks, because if consumers lose confidence, they could switch to another comparable retailer.

Management (or mismanagement) of certain sustainability issues, therefore, has the potential to affect company valuation through impacts on profits, assets, liabilities, and the cost of capital.

Investors would obtain a more holistic and comparable view of performance with Multiline and Specialty Retailers & Distributors companies reporting metrics in their regulatory filings on the material sustainability risks and opportunities that could affect value in the near and long term. This would include both positive and negative externalities, and the non-financial forms of capital that the industry relies on for value creation.

Specifically, performance on the following sustainability issues will drive competitiveness within the Multiline and Specialty Retailers & Distributors industry:

- Managing energy use in the retail space and in distribution centers;
- Protecting financial and nonfinancial consumer data;
- Maintaining and cultivating a diverse workforce;
- Ensuring labor rights and fair working practices; and

- Managing and advertising sustainable product sourcing and packaging.

INDUSTRY SUMMARY

The Multiline and Specialty Retailers & Distributors industry encompasses a variety of retailing categories. Major segments within this industry are department stores, which offer a wide array of general goods; mass merchants, which are similar to department stores but also sell fresh groceries; home products stores, which sell home repair and maintenance products;[1] and warehouse clubs, which sell a similar array of goods as mass merchants but require shoppers to pay a membership fee. This industry also comprises various other retailing categories, such as dollar stores, automotive dealers, catalog and TV retailers, and sporting goods stores, as well as distributors such as electronics wholesalers, and automotive wholesalers.[I] Common to the retail companies is that they manage complex supply chains to curate and sell goods in brick-and-mortar stores. Many of these companies have their own private-label brands, which can have higher profit margins and whose production is generally outsourced.[2] This smaller distribution segment of the brief[II] makes up 18 percent of the industry revenue.[3]

Companies in this industry sell directly to consumers as well as to other businesses. The ability to buy in bulk makes warehouse clubs especially attractive to small businesses, which constitute a third of their customers.[4] Revenues from other businesses are important in many different segments of this industry. For example, for companies in the home products segment, such as Lowe's, business purchases make up 39 percent—the largest segment—of revenue on average.[5]

The total global revenue in the Multiline and Specialty Retailers & Distributors industry was approximately $2.85 trillion as of July 1, 2015.[6] Most U.S.-listed companies in this industry have the majority of their operations in North America. The U.S. market is especially saturated.[7] For example, 90 percent of all Americans live within 15 minutes of a Walmart.[8] This has driven the steady expansion of some companies into developing markets.[9] In 2010, 76 percent of Walmart's revenue was from the United States and 24 percent was from the rest of the world; in 2015, these figures shifted to 71.7 and 28.3 percent, respectively.[10]

Walmart is the clear industry leader in terms of market share, with roughly $486 billion in revenue in fiscal year (FY) 2015. The other four of the five representative companies in this industry (listed in Appendix I) are Costco, Home Depot, Target, and Macy's, with revenues of roughly $113 billion, $83 billion, $73 billion, and $28 billion, respectively.[11]

The Multiline and Specialty Retailers & Distributors industry is highly concentrated. In the top three segments of the industry by revenue—mass merchants, home products stores, and department stores—the top two to four companies make up roughly 80 percent of the entire U.S. market for that segment.[12] Even though the industry is not particularly capital-intensive (although in expensive real estate markets, storefronts can be a prohibitive cost for smaller players),[13] the high market share of the top players presents high barriers to entry. The economies of scale and vast geographic presence

[I] Industry composition is based on the mapping of the Sustainable Industry Classification System (SICS™) to the Bloomberg Industry Classification System (BICS). A list of representative companies appears in Appendix I.

[II] This brief mainly focuses on the retailing segment of the Multiline and Specialty Retailers & Distributors industry.

of the top companies give them such a pricing and convenience advantage that it is difficult for small competitors to exist in anything but niche markets, such as high-end organic grocery stores.[14]

This industry has a median net income margin of 3.44 percent.[15] This relatively low margin exists because high levels of competition among the top two to four companies in all the sub-segments put downward pressure on product prices. Stores can be highly substitutable for one another if they carry the same or similar products, causing companies to differentiate themselves on price, convenience, breadth of offerings, and quality of customer service. This relatively high substitutability of service makes companies in this industry especially vulnerable to headline and reputational risk.[16]

The industry roughly follows general economic growth, benefiting from the increased consumer spending that accompanies lower unemployment, lower gasoline prices, and low interest rates.[17] The industry's global supply chains expose its companies to currency fluctuation risk, as well as foreign policy risk (e.g., minimum-wage increases or political instability). Retailers that are most able to manage their own distribution, or that effectively contract with third parties (the distribution segment of this industry) and keep prices low, have a significant competitive advantage.

The high-end retailers in this segment, such as department stores, have more cyclical revenues. They were hurt by the decrease in consumer confidence and spending that followed the 2008 recession, while warehouse clubs and supercenters (which are warehouse clubs without membership fees), with their discounted prices, experienced continued revenue growth.[18] Warehouse clubs and supercenters generally benefit from a decrease in disposable income, as it drives many middle-income consumers to more economical options. These types of retailers also benefit from the growth in government subsidy programs like food stamps.[19]

Companies in this industry are deeply dependent on fourth-quarter holiday sales. For example, in its FY2014 Form 10-K filing, Best Buy discloses that roughly one-third of its revenue and more than one-half of its net earnings are generated during this season.[20] To handle the industry's busiest season, the retail labor force swells.[III] The retail industry hired 821,000 temporary workers for the 2014 holiday season to handle the increase in customer demand.[21] Target alone accounted for 70,000 of these workers.[22]

The majority of costs in this industry come from merchandise purchases, which represent between 66.9 and 74.8 percent of revenue for the warehouse and superstore, department store, home improvement store, and consumer electronic segments. Labor is the second-highest cost center, making up between 8.7 and 13 percent of revenue for the same segments.[23]

In the past decade, the trend among industry companies was to build vast, suburban stores. More recently, U.S. demographic trends are shifting back to urban centers,[24] and many industry players are opening smaller stores in these areas.[25] These urban stores are substantially smaller, ranging from 10,000 to 40,000 square feet in the case of Walmart, compared to superstores which can be as large as 230,000-square-feet. While significantly reducing the number and variety of items sold, these smaller

[III] The Multiline and Specialty Retailers & Distributors SICS industry captures about half the entire U.S. retail market, according to the author's mapping of SICS to BICS.

stores are following the trend toward offering fresh food to be become a one-stop-shop for customers.[26]

Retail store foot traffic has been on a decline since 2010, with foot traffic levels in November and December (typically the busiest months) of 2013 only half those of 2010.[27] This is likely driven by the growth of e-commerce, as customers are able to use online marketplaces to compare prices, to make purchases, and to enjoy the convenience of shipping. Traditional retail models have relied on getting customers in the door frequently and enticing them to make more purchases. The changing landscape brought about by e-commerce has caused some retailers to rethink how brick-and-mortar stores can serve a dual function and become integrated with the growing online retail market. This requires greater technology investment, such as in data storage. For example, Macy's has enabled half of its 840 stores to process online orders.[28]

The integration of storefront and e-commerce—called omni-channel retail—is a growing industry trend. This dynamic model allows retailers to provide customers with a wider range of services. For example, a company could ship products that it doesn't have in stock in store directly to customers, or to a store close to them. The research group Forrester predicts that 25 percent of retail growth between 2014 and 2018 will come from online sales. For example, while e-commerce sales represented only 3 percent of Walmart's sales in FY2014, the company expects these sales to grow by 30 percent in FY2015.[29]

Company valuation in this industry is typically based on year-over-year sales growth, a company's EBITDA[IV] margins, and the consumer confidence index, as well as more industry-specific metrics like same-store sales and inventory-to-sales spread.[30] Sustainability issues affecting operational efficiency have a direct impact on EBITDA, and issues involving product selection and sourcing impact inventory-to-sales spread.

NOTE ON INDUSTRY STRUCTURE

In developing this brief and determining disclosure topics and accounting metrics for the Multiline and Specialty Retailers & Distributors industry, SASB used a "pure-play" definition of the industry, covering the following retail industries in separate standards: Apparel, Accessories & Footwear; Food Retailers & Distributors; Drug Retailers & Convenience Stores; and E-Commerce.

While this approach is necessary to ensure a coherent understanding of industry drivers and challenges, it does not always reflect the current structure of the industry, in which multiline and specialty retailers and distributors are often directly involved in the retailing of the types of goods more directly addressed in these other industries.

Therefore, depending on the specific activities and operations of multiline and specialty retailers and distributors, sustainability topics and accounting metrics associated with Apparel, Accessories & Footwear; Food Retailers & Distributors; Drug Retailers & Convenience Stores; and E-Commerce industries may also be relevant to consider.

LEGISLATIVE AND REGULATORY TRENDS IN THE MULTILINE AND SPECIALITY RETAILERS & DISTRIBUTORS INDUSTRY

Regulations in the U.S. and abroad represent the formal boundaries of companies' operations, and are often designed to address the social and environmental externalities that businesses can create. Beyond formal regulation, industry

[IV] Earnings before interest, taxes, depreciation, and amortization.

practices and self-regulatory efforts act as quasi-regulation and also form part of the social contract between business and society. In this section, SASB provides a brief summary of key regulations and legislative efforts related to this industry, focusing on social and environmental factors.[V]

The Multiline and Specialty Retailers & Distributors industry faces a light amount of regulation. The three main regulatory issues involve employee wages, tax legislation for online sales, and data security laws. Employee wage laws and data security laws are both becoming more stringent. This industry is regulated by a number of governmental rules and bodies, most importantly, the Fair Labor Standards Act (FLSA), which stipulates a minimum wage and working conditions for workers; the Occupational Safety and Health Administration (OSHA), which governs issues around workplace safety; and the National Labor Relations Board (NLRB), which protects workers' rights to certain types of unionization.

In 2014, 3.3 million workers in the U.S. made minimum wage, and 14 percent of those were in the retail industry, representing the second-highest segment after the leisure and hospitality industry.[31] The Fair Minimum Wage Act was proposed in 2013 to amend the FLSA to raise the federal minimum wage to $10.10 an hour, from its current rate of $7.25.[32] The bill is opposed by the National Retail Foundation (NRF), the largest industry group for this sector, on the grounds that it will increase industry costs.[33] However, the Retail Industry Leaders Association (RILA), another large industry association, does not have an official stance on the issue.[34] This bill was voted down by the Senate in April 2014, but Democrats have vowed to reintroduce it, citing its massive popular support.[35] President Barack Obama has urged Congress to adopt it.[36] The lack of a unified industry stance on the bill could be attributed to the potential upside for the industry, as many companies, like Walmart, could see a substantial revenue increase from their low-income consumers, whose wages would increase.[37]

In response to increasing political and popular support for wage increases, 14 states raised their minimum wage in 2014.[38] Three major U.S. cities have announced plans to raise their minimum wage to as much as $15 an hour within a decade.[39] This political momentum indicates that a federal minimum-wage increase in the coming years is possible.

In a related development, President Obama has issued a directive to the Department of Labor to raise the threshold for overtime payments.[40] Currently, only salaried workers who make $455 per week or less are legally required to be paid for overtime. While the new threshold is not known, some have recommend increases of the threshold to as high as $984 a week, which, if implemented, would significantly raise labor costs in this industry.[41] On June 30, 2015, the U.S. Department of Labor announced a notice of proposed rulemaking (NPRM), accepting public comment for this rule.[42]

Along with labor laws, tax rules can have important implications for the profitability of the industry. The main external competition for this industry comes from e-commerce companies such as Amazon. One of the main competitive advantages that e-commerce companies have is that they can avoid sales tax if they do not have operations in the state in which the customer is purchasing a product. Under current laws, the onus is on the consumer to report the purchase, which is subject to a use tax. Given the typical

[V] This section does not purport to contain a comprehensive review of all regulations related to this industry, but is intended to highlight some ways in which regulatory trends are impacting the industry.

financial value of an individual's online purchases, this rarely happens.[43]

In response, the Marketplace Fairness Act of 2015 has been proposed to give states the ability to collect sales tax on goods purchased by state residents, regardless of the location of the business from which the goods are bought.[44] While most companies in this industry have e-commerce segments and therefore could be affected negatively by this legislation, many of them already have operations in most U.S. states, so they are not receiving the same tax benefits that some e-commerce companies are. This bill is strongly supported by the NRF and RILA.[45]

As the industry moves toward more online sales, data security issues are becoming increasingly important. Calls for stricter national legislation around the issue of data security are growing, and 46 states currently have related laws on the books.[46] These laws generally deal with how many consumer's records need to be breached before they should be notified. Some companies would like to have more latitude in choosing when to inform consumers about a breach, but some laws, like the Florida Information Protection Act of 2014, have instituted a $1,000-a-day penalty for failure to notify the affected customers, which rises to $50,000 a month 30 days after a breach is detected.[47] In response to a rise in data breaches, California proposed the Data Breach Notification Law in October 2014, which places greater responsibility on retailers for breaches of data security, requiring them to provide services like identity-theft protection for any affected customer for a minimum of 12 months.[48] As of mid-2015, at least 32 states have proposed similar laws.[49]

The U.S. retail industry is center stage for credit card fraud, as unsecure magnetic-strip credit and debit cards are the source of a vast majority of frauds.[50] To combat fraud, payment-processing giants Visa and MasterCard have delivered an ultimatum to traditional retailers that by October 2015, they must either prepare their stores to accept the more secure "pin and chip" Europay, Mastercard, and Visa (EMV) standard, or accept liability for fraudulent charges. Thus far, this liability had fallen on the payment-processing firms. This action will increase the difficulty of creating fraudulent credit cards and will likely move more fraud from brick-and-mortar stores to e-commerce operations.[51] If fraud is detected or a charge is disputed, the credit card company issues a chargeback, or a deduction of the payment from the firm's account.[52]

As the discussion above demonstrates, emerging laws and public scrutiny on fair wages and data security are likely to have significant implications for the cost structure of companies in the industry, pressuring their margins.

SUSTAINABILITY-RELATED RISKS AND OPPORTUNITIES

Industry drivers and recent regulations suggest that traditional value drivers will continue to impact financial performance. However, intangible assets such as social, human, and environmental capitals, company leadership and governance, and the company's ability to innovate to address these issues are likely to increasingly contribute to financial and business value.

Broad industry trends and characteristics are driving the importance of sustainability performance in the Multiline and Specialty Retailers & Distributors industry:

- **Dependence on low-wage workers:** This industry has a large low-wage workforce, and a significant reliance on temporary workers, especially during the holiday season. Companies can cultivate a positive reputation and improve operational productivity by ensuring fair treatment of their workers.

- **Purchasers from global markets and drivers of consumption:** Companies in this industry source thousands of goods from global markets. These products can have significant lifecycle environmental and social impacts. As consumers become more aware of the broader ramifications of the products they choose to buy and demand more sustainable options, retailers will benefit from higher standards around product selection, packaging, and marketing.
- **Environmental footprint of retail spaces:** Most companies in this industry maintain massive amounts of retail spaces that consume significant quantities of energy. Companies that are able to achieve high cost savings through energy efficiency or that gain efficiencies and reputational benefits through the use of renewable energy stand to increase their profitability while lowering their environmental footprint from energy consumption.
- **Repositories of sensitive customer information:** Companies in this industry interact with thousands of customers on a daily basis. The industry is a target for data security breaches that can put customers' sensitive information at risk. Companies that can proactively manage data security in both brick-and-mortar and online stores can lower their risk profile and maintain consumer trust.

As described above, the regulatory and legislative environment surrounding the Multiline and Specialty Retailers & Distributors industry emphasizes the importance of sustainability management and performance. Specifically, recent trends suggest a regulatory emphasis on labor and consumer protection, which will serve to align the interests of society with those of investors.

The following section provides a brief description of each sustainability issue that is likely to have material financial implications for companies in the Multiline and Specialty Retailers & Distributors industry. This includes an explanation of how the issue could impact valuation and evidence of actual financial impact. Further information on the nature of the value impact, based on SASB's research and analysis, is provided in Appendix IIA and IIB.

Appendix IIA also provides a summary of the evidence of investor interest in the issues. This is based on a systematic analysis of companies' 10-K and 20-F filings, shareholder resolutions, and other public documents, which highlights the frequency with which each topic is discussed in these documents. The evidence of interest is also based on the results of consultation with experts participating in an industry working group (IWG) convened by SASB. The IWG results represent the perspective of a balanced group of stakeholders, including corporations, investors or market participants, and public interest intermediaries.

The industry-specific sustainability disclosure topics and metrics identified in this brief are the result of a year-long standards development process, which takes into account the aforementioned evidence of interest, evidence of financial impact discussed in detail in this brief, inputs from a 90-day public comment period, and additional inputs from conversations with industry or issue experts.

A summary of the recommended disclosure framework and accounting metrics appears in Appendix III. The complete SASB standards for the industry, including technical protocols, can be downloaded from www.sasb.org. Finally, Appendix IV provides an analysis of the quality of current disclosure on these issues in SEC filings by the leading companies in the industry.

ENVIRONMENT

The environmental dimension of sustainability includes corporate impacts on the environment. This could be through the use of natural resources as inputs to the factors of production (e.g., water, minerals, ecosystems, and biodiversity) or environmental externalities and harmful releases in the environment, such as air and water pollution, waste disposal, and greenhouse gas (GHG) emissions.

The Multiline and Specialty Retailers & Distributors industry requires vast amounts of commercial space to showcase and store products. The commercial sector purchases around 36 percent of U.S. electricity.[53] The electricity required to control the temperature and light in retail spaces, and, in the case of food, to refrigerate perishables, is a major source of industry expense and can also contribute to externalities such as climate change and local air pollution. Companies in the industry can improve their often-thin profit margins by investing in energy management for their stores.

Energy Management in Retail & Distribution

Electricity consumption based on fossil fuels and other conventional energy sources can contribute to environmental impacts, including climate change and pollution. These impacts have the potential to affect the operations of multiline and specialty retailers and distributors that source a significant proportion of their electricity from conventional-energy-dependent sources. Sustainability factors—such as the increasing number of GHG-emissions regulations, incentives for energy efficiency and renewable energy, and risks associated with nuclear energy and its increasingly limited license to operate—are leading to increases in the price of conventional electricity sources while making alternative sources more cost-competitive. Therefore, it is becoming increasingly important for companies to manage their overall energy efficiency and their access to alternative energy sources.

Companies in this industry have facilities in strip malls, enclosed malls, and warehouses, as well as in stand-alone retail buildings that can be as large as 260,000 square feet.[54] Energy costs in retail spaces or warehouses vary based on geography, hours of operation, the number of employees, and the amount of refrigeration used.[55] Refrigeration costs, which often represent the largest energy cost for companies, could increase with the general industry trend toward selling more food.

Companies' ability to control their energy consumption depends in part on whether they lease or own their retail and distribution spaces. But regardless, companies can take measures to manage their energy consumption and, therefore, their costs. To lower their energy usage, companies can, for example, reduce their lighting power density, construct stores to take advantage of natural light and to have better insulation, and invest in more efficient heating, ventilating, and air-conditioning (HVAC) systems.[56]

The industry's thin margins make energy efficiency particularly vital to improving financial performance. Furthermore, companies can decrease their energy price risk by investing in on-site renewable energy generation, or contracting with renewable energy providers. Company performance in this area can therefore be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Total energy consumed, percentage grid electricity, and percentage renewable energy.

Evidence

The Multiline and Specialty Retailers & Distributors industry consumes a relatively significant share of total electricity used in the U.S. Commercial buildings as a whole use 18 percent of the total energy consumed in the U.S.[57] In 2008, there were approximately 657,000 retail buildings in the U.S., representing about 13.5 percent of all U.S. commercial space.[58] Energy efficiency in this industry could therefore play an important role in influencing electricity generation in the U.S. economy, with implications for GHG emissions and other environmental impacts.

At the same time, the industry spends a large amount of its resources on electricity annually. Energy consumption by all retail space in the U.S. equates to approximately $21 billion worth of electricity annually.[59] Retail spaces that do not sell food have an average electricity cost of $1.19 per square foot, and those that do sell food have a significantly higher cost of $3.74 per square foot.[60]

Energy costs are particularly important to manage in the face of rising electricity prices. In the U.S., the average retail price of electricity for the commercial sector has increased by 34 percent, from 7.7 cents per kilowatt-hour (kWh) in 2001 to 10.3 cents per kWh in 2015, with wide regional variations.[61] While retail electricity price increases have historically been lower than the general rate of inflation in the U.S.,[62] this trend is expected to change; the U.S. Energy Information Administration's long-term projections show that average end-use prices for electricity across sectors are expected to increase by around 4.5 percent between 2013 and 2020, in 2013 cents per kWh, and by 12.5 percent between 2013 and 2035.[63] In fact, compared with 2013 prices, real electricity prices are expected to increase across various scenarios, including low and high economic growth and low and high oil prices.[64]

These trends are reflected in management concerns about energy costs. Fifty-seven percent of retail CEOs say that they are concerned about high or volatile energy costs, according to a PwC survey.[65]

The industry's significant energy use and thin margins, as well as the general trend of rising electricity prices, mean that companies would benefit from energy efficiency measures, which could help achieve cost savings. Furthermore, renewable energy can play a part in managing energy costs. In recent years, modular and distributed renewable energy technologies, such as solar, have become significantly more affordable.[66] Major electricity consumers, such as companies in this industry, can therefore offset some of their electricity consumption from the grid through on-site electricity generation using such technologies.

Investing in energy efficiency programs and renewable energy projects can lower a company's cost structure, improving its margins and, ultimately its risk profile. The Multiline and Specialty Retailers & Distributors industry has a median net income margin of 3.44 percent, and energy costs are around 5.5 percent of operating costs for retail companies. Therefore, if a company hypothetically achieved a 15 percent reduction in energy consumption, it would raise its margins to around 4 percent.[67]

Home Depot, in its FY2015 Form 10-K, discloses, "Our energy management team continued to implement strict operational standards that establish energy efficient practices in all of our U.S. facilities. These include HVAC unit temperature regulation and adherence to strict lighting schedules, which are the largest sources of energy consumption in our stores, as well as use of energy management systems in each store to monitor energy efficiency. We estimate that by implementing and utilizing these energy saving programs, we have saved over 8.6 billion kilowatt hours (kWh) since 2004."[68] A savings of 8.6 billion kWh is worth nearly $900 million.[69]

Walmart is implementing a program to both increase its production of renewable energy and decrease the energy intensity of its retail stores. The company projects that by 2020, the program will generate savings of $1 billion a year.[70] From a 2010 baseline, Walmart achieved a 7.4 percent reduction in energy intensity per square foot in 2013.[71] In 2011, Lowe's rolled out a series of building energy-efficiency programs, such as demand-control ventilation systems, resulting in a savings of at least $10.5 million per year.[72] Similar initiatives at Target are projected to save the company $5.6 million annually.[73] Ingram Micro, a wholesale distributor of information technology products, reports that a lighting retrofit at just one of its logistics centers (it has 122)[74] is projected to save the company $3.25 million between 2015 and 2024.[75]

On a more granular level, Staples tested some aggressive energy-management tactics at its store in Cambridge, Massachusetts, including upgrading HVAC and lighting units, utilizing occupancy sensors, and training employees in energy management training. The store had initial energy costs of approximately $55,000 per year. After implementing these energy efficiency projects, the store reduced its energy use by 40 percent, saving Staples more than $20,000 per year. The investments all had a payback period of two years or less.[76] While these tactics would likely have varying effects depending on a store's region, SASB estimates that Staples would generate annual savings of roughly $36 million by replicating the projects throughout its roughly 1,800 stores.[77]

Companies can reduce their risk from electricity price changes by installing on-site renewable energy or through strategic sourcing of renewable energy from other providers. For example, Walmart, by the end of 2013, had more than 335 different renewable energy projects in development, which provided 2.2 billion kWh of electricity annually. The company has installed more than 250 solar energy systems, each providing 15 to 30 percent of a store's electricity needs.[78] In addition, 84 of Walmart's stores in Brazil have implemented bidding processes for energy from small hydropower plants nearby, and the company claims that these stores have saved, on average, 11.5 percent on their energy bills.[79]

Value Impact

Energy costs are a relatively small portion of total costs for multiline and specialty retailers and distributors, but the inherently low margins in this industry mean that companies can improve financial performance by implementing long-term energy management strategies. These efforts require an increase in capital expenditures (e.g., for HVAC upgrades or on-site solar panels), but these projects typically have a short payback period. Cost savings can be passed on to consumers through lower prices, which can help companies gain market share and increase their revenue. Improved margins and strategies to protect against energy price risks could also lower the risk profile of companies and therefore their cost of capital.

The probability and magnitude of these impacts will likely both increase in the future, as emerging environmental regulations affecting energy generation continue to influence energy costs.

Disclosure on total energy consumed provides analysts the ability to assess improvements in company performance over time and, when normalized, can provide a comparative measure of energy efficiency. The percentage of a company's energy coming from grid electricity indicates its exposure to electricity price increases, as utilities internalize the costs of carbon pollution (for example, through new GHG mitigation regulations). Disclosure on the percentage of renewable energy used indicates how well a company is positioned to capture possible cost savings and ensure stable energy prices from the use of renewables (renewable energy can be obtained through long-term power purchase agreements that allow for stability in prices paid for electricity).

SOCIAL CAPITAL

Social capital relates to the perceived role of business in society, or the expectation of business contribution to society in return for its license to operate. It addresses the management of relationships with key outside stakeholders, such as customers, local communities, the public, and the government.

This industry is particularly susceptible to the downside risk of data breaches, as revenue growth is dependent on consumers' trust in the security of their personal and financial information. Companies in this industry have personal and financial data related to the purchase transactions of millions of customers. Companies are increasingly gathering more data from customers' online shopping activities for improved marketing and revenue-generation purposes. This is heightening the importance of data protection. A breach of customer data can cause companies to lose the trust of their consumers, as well as face increased scrutiny from regulators. Companies in this industry need to be careful to adopt proper data protection measures and meet breach-disclosure expectations to mitigate these risks.

Data Security

Consumers trust retail companies with their financial and personal data every time they make a non-cash transaction. Credit cards and debit cards have steadily eclipsed cash and checks as consumers' preferred payment methods, and were used to pay for more than half of retail goods and services purchased in the U.S. since 2003.[80] In these transactions, retailers build up a relationship of trust with consumers, assuring them of the safety of their personal information.

Data breaches can originate through breaches of the physical payment technology at retail stores, called point-of-sale (POS) breaches, as well as through a myriad of online hacking methods.

As consumers become more educated about the threat of cyber crime and POS data breaches, particularly in the wake of continued high-profile attacks, data security will become increasingly important for companies to keep or gain market share. This is an opportunity for the most trusted brands to position themselves favorably in the eyes of consumers. Furthermore, data breaches that result in fraudulent credit card transactions can result in significant costs for retailers from charge-backs issued by credit card companies.

Companies that do find themselves compromised must walk a fine line between disclosing the information publicly as soon as possible to avoid more damage to consumers, and maintaining an optimal amount of secrecy to deal with the breach without tipping off the intruder. Companies that are perceived as intentionally not disclosing information about a data breach to the customers who have been affected open themselves up to public scrutiny as well as potential litigation.

Companies can take several actions to improve data security, including placing high-level executives in charge of data security to have a clear chain of command in the event of a breach, being proactive in screening their systems to follow up on any irregularities, and updating their systems as the nature of data breaches evolves. These types of measures can be costly but ultimately necessary as data breaches increase in both cost and frequency. Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Discussion of management approach to identifying and addressing data security risks; and
- Number of data security breaches, percentage involving customers' personally identifiable information (PII), and number of customers affected.

Evidence

Data security is a massive problem industry-wide, with major companies in the industry mentioning data security risk in their FY2014 Form 10-K filings.[81] For example, Sears discloses the comprehensive nature of this challenge, stating, "If individuals are successful in infiltrating, breaking into, disrupting, damaging or otherwise stealing from the computer systems of the Company or its third-party providers we may have to make a significant investment to fix or replace them, we may suffer interruptions in our operations in the interim, we may face costly litigation, government investigations, government enforcement actions, fines and/or lawsuits…and our reputation with our members and customers may be significantly harmed."[82]

Because the methods and tools of criminals constantly evolve, data security is a complex risk to manage, as demonstrated by a U.S. Computer Emergency Readiness Team alert issued in July 2014, which stated that more than 1,000 U.S. retailers had been affected by a piece of malware capable of stealing sensitive information. The alert warned all U.S. retailers to scan their systems for possible infection, as they most likely would not know if their systems had been compromised.[83]

Data security breaches could have significant repercussions for a retailer's market share and growth. A 2014 survey of CEOs across industries by PwC found that 69 percent admitted to being concerned that cyber-attacks could hinder company growth.[84] Target's high-profile data breach, discussed later in this section, was likely the major factor in the company's 5 percent drop in its American Consumer Satisfaction Index consumer sentiment score in the year following the incident.[85]

Data breaches, both large and small, can also create significant direct and indirect costs for companies in the industry. Research by the Ponemon Institute showed that between 2010 and 2014, the cost of the average data breach (involving 100,000 or fewer records) increased from $3.8 million to more than $5.8 million (the research excluded larger data breaches, with more than 100,000 lost records, to avoid skewing the results, as the financial cost is significantly higher).[86] The largest factor in the increased cost of the average breach was the loss of customers, followed by legal defense costs. Retail companies are particularly at risk, as the probability of a material data breach (which the Ponemon Institute defines as one that involves a minimum of 10,000 records) over the next two years is nearly 23 percent, second only to the public sector.[87] Constant data security attacks, coupled with two recent high-profile breaches in the retail industry, have resulted in increased concern for the security of customer data.[88]

Retailers face the risk of acute, high-magnitude impacts on their financial results from larger breaches. In the fourth quarter of 2013, Target was the victim of a high-profile data breach involving the financial information of 40 million customers and the personal records for an additional 70 million customers.[89] In its FY2015 Form 10-K, Target discloses that the breach cost the company $252 million between 2013 and 2014, offset by $90 million in expected insurance recoveries, for a net expense of $162 million.[90] In August 2015, Target's costs further increased as it reached an agreement with Visa to reimburse card issuers up to $67 million for fraudulent charges made as a result of the breach.[91]

In the quarter following the announcement of the breach, Target suffered a 5.5 percent decline in store traffic, a 2.5 percent decline in same-store sales, and a 16 percent drop in earnings.[92] As both financial and personal information was stolen during the breach, the company is also facing 68 class action lawsuits.[93] Dealing with the massive breach also required substantial involvement by C-level executives, especially in the absence of a chief information security officer (CISO). Ultimately, the incident caused then-CEO Gregg Steinhafel to step down.[94] Target has since opened up a dedicated cyber-security center.[95]

In September 2014, Home Depot also faced a very large data breach, with the financial data of 56 million cards reportedly compromised.[96] In its FY2014 Form 10-K, the company states, "If we do not maintain the privacy and security of customer, associate, supplier or Company information, we could damage our reputation, incur substantial additional costs and become subject to litigation."[97] For the September 2014 data breach, Home Depot is estimating an initial cost of $63 million, of which insurance will cover $30 million.[98] It is also facing a class-action lawsuit that alleges that the company failed to notify customers in a timely manner.[99]

As discussed in the Legislative and Regulatory Trends section, evolving regulations related to disclosing data breaches to customers in a timely manner can expose companies to additional costs if they fail to meet expectations in this regard.

According to research by the Ponemon Institute, companies that are proactive in protecting against these breaches and that have a strategic response plan in place can reduce the average cost of a data breach by as much as $21 per record. Having a CISO can further reduce the cost per record by $10.[100] This type of preparedness, in a relatively small-scale breach of 100,000 records, can result in roughly $3 million in savings.[101]

Value Impact

As companies in this industry compete on similar or easily substitutable goods, management of the security of personal and financial information could be a major differentiating factor for consumers, with significant impact on companies' market share and revenue. The reputational damage a major breach can cause lowers the value of company's brand.

Companies may face chronic increases in selling, general, and administrative expenses (SG&A) and extraordinary expenses for small but frequent data security incidents. High-impact, low-probability data security incidents can generate substantial one-time costs to remediate, in addition to contingent liabilities, with an impact on companies' risk profile and cost of capital. Preventative efforts can cause an increase in capital expenditures and operating costs; however, these efforts could lower both the probability of a breach and the magnitude of costs incurred if a breach occurs.

If companies in this industry experience a breach and fail to disclose it in a timely manner, they could face additional regulatory action and class action lawsuits from consumers, both of which could result in serious fines and impacts on contingent liabilities.

Understanding the magnitude of past breaches, and a company's related actions to prevent or address such breaches, allows analysts to compare the risk exposure of companies and their ability to address data security issues effectively in the future. The probability and magnitude of impacts from breaches are expected to increase in the near and long term, as breaches become more frequent and sophisticated.

HUMAN CAPITAL

Human capital addresses the management of a company's human resources (employees and individual contractors), as a key asset to delivering long-term value. It includes factors that affect the productivity of employees, such as employee engagement, diversity, and incentives and compensation, as well as the attraction and retention of employees in highly competitive or constrained markets for specific talent, skills, or education. It also addresses the management of labor relations in industries that rely on economies of scale and compete on the price of products and services. Lastly, it includes the management of the health and safety of employees and the ability to create a safety culture within companies that operate in dangerous working environments.

The retail industry as a whole is the largest employer in the U.S., with a large part of the workforce continually interacting with customers. As a result, management of human capital around issues of diversity and labor relations affects operating costs and efficiency, as well as the company's social license to operate, since labor disputes often receive media and public attention. An inclusive, fairly compensated workforce is an asset that can contribute to long-term revenue growth for companies in the retail industry.

Workforce Diversity & Inclusion

Companies in this industry can benefit from ensuring that their company culture and hiring and promotion practices embrace the building of a diverse workforce. However, women and minorities are generally underrepresented in board and management structures, and women are often overrepresented in junior positions.[102] This can result in allegations of discriminatory labor practices, including those related to promotions and wages. The resulting lawsuits can both eat into the thin margins of this industry, as well as cause reputational damage for the responsible companies. Retailers that actively work to recruit and nurture a diverse workforce at all levels of the organization, including traditionally underrepresented groups, may also be better able to capture demand from their diverse customer base.

This industry is consumer-facing and relies on its employee's ability to communicate effectively with customers during the sales process and adapt to changing consumer demands for products. Companies that are successful in recruiting and developing a diverse and inclusive workforce that reflects the makeup of local talent pools and their customer base can enhance shareholder value over the long term. A more diverse and engaged workforce can contribute to better customer service, a greater reputation, and more productive workers.

This is especially important in a field where superior customer service can differentiate a company from a competitor that sells similar products. A diverse workforce is also important in the context of the demographic shift that the U.S. population is currently undergoing, with an increase in minority populations. Retailers that respond to this demographic trend and employ staff who will be able to recognize the needs of these populations may be better able to capture demand from these segments, which can provide companies a competitive advantage.

Ways in which companies can successfully foster a diverse and inclusive workforce include providing adequate career support to traditionally underrepresented employees and putting in place policies and processes to discourage implicit biases in promotions. Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Percentage of gender and racial/ethnic group representation for (1) management and (2) all other employees; and
- Amount of legal and regulatory fines and settlements associated with employment discrimination.

Evidence

This industry has not yet reached gender and racial parity in positions of authority. Industry-wide data on gender and racial diversity is difficult to find, but some industry leaders provide transparency into their workforce. These disclosures highlight both the relative gains being made by industry leaders and the need for concerted recruitment and mentorship programs at the company level to achieve diversity numbers commensurate with representation in the total population. For example, between 2003 and 2013, Walmart saw an increase in female officers, from 19 percent to 31 percent, as well as an increase from 11 percent to 23 percent for officers who were people of color.[103] Given that the U.S. population is 37.4 percent people of color, and in 2003 was 32.1 percent people of color, this is still not reflective of the total population.[104]

A 2012 U.S. Census Bureau estimate predicts that the size of the Hispanic population will double between 2012 and 2060, to roughly a third of the total U.S. population. Over the same period, the African American population is projected to increase from 13 to 15 percent of the total population, and the Asian American population to increase from 5 to 8 percent. At the same time, the white American population is projected to shrink from 63 to 43 percent.[105] These are vital consumer trends that companies will need to respond to in order to keep or expand their market share.

A 2011 Deloitte study highlights the increasing importance of a retailer's staff matching the demographics of its community in order to understand and market toward previously ignored demographics.[106] In an example from a related industry, the study describes how a nearly failing brand of charcoal was revitalized, with 4 to 6 percent growth, by an employee insight that the company should market its products to the family-oriented Hispanic demographic, in which large family cookouts are popular.[107] According to a 2014 PwC survey, 59 percent of retail CEOs felt that the current U.S. demographic shifts will have a "huge impact on their business over the next five years."[108]

In its FY2014 Form 10-K, Staples states, "We believe that differences in age, race, gender, gender identity, nationality, sexual orientation, physical ability, background and thinking style allow us to be more innovative as a company."[109] This is echoed by a 2009 study from the University of Illinois, Chicago, that found that greater racial and gender diversity was correlated with "increased sales revenue, more customers, and greater relative profits."[110]

Similarly, Lowe's FY2014 Form 10-K filing directly addresses this issue, stating: "In many of our stores our employees must be able to serve customers whose primary language and cultural traditions are different from their own. A critical challenge we face is attracting and retaining a sufficiently diverse workforce that can deliver a relevant, culturally competent and differentiated experience for a wide variety of culturally diverse customers. Also, as our employees become increasingly culturally diverse, our managers and sales associates must be able to manage and work collaboratively with employees whose primary language and cultural traditions are different from their own."[111] The filing further says that Lowe's inability to meet this challenge could result in losing market share to competitors who can attract a larger variety of demographics.

Women represent the largest share of total U.S. consumer spending—$4.3 trillion out of $5.9 trillion[112]—suggesting that retail companies should be actively seeking to correct the current deficit of women in leadership roles (among the 18 companies whose data on the percentage of women in management roles is currently available on the Bloomberg terminal, the average and median are both around 24 percent for FY2014).[113] This could create a competitive advantage through product selection and marketing strategies that are more likely to appeal to women.

Indeed, research suggests that having women in leadership roles pays off for investors. A McKinsey study found that retail companies in the top quartile for female representation on executive committees had higher average returns on equity and EBIT margins[VI] than companies that had all-male executive committees.[114] While not specific to the retail industry, other studies also show a link between financial performance and female representation in leadership and on boards of directors.[115]

A lack of diversity, if it is the result of discriminatory practices, can lead to significant legal and reputational damage. Some companies in this industry have faced lawsuits alleging that employee hiring or promotions had a systemic gender bias or that women were discriminated against and paid lower wages.

For example, Costco is currently facing a class action lawsuit alleging that inherent biases in the firm's promotion processes are to blame for the fact that, between 1990 and 2004, only 103 of the 561 promotions to assistant general manager were given to women. Costco has currently reached an $8 million preliminary settlement with the plaintiffs.[116] In 2010, Walmart lost a lawsuit to the U.S. Equal Employment Opportunity Commission (EEOC) and was forced to pay $11.7 million in lost wages for discriminating based on gender in its warehouse hiring practices.[117] In 2015, Target paid $2.8 million to settle charges by the EEOC that its screening process for higher-level positions discriminated based both on sex and race.[118] In all these cases, the reputational effect, particularly due to the significant attention

[VI] EBIT margins are a company's earnings, before accounting for interest and taxes, divided by its net revenue. Higher EBIT margins are a good indication of company health.

that the industry receives on these issues from the media, must be considered along with the more easily quantifiable fines or settlements.

Value Impact

Companies that have transparent hiring, promotion, and wage practices that actively seek to promote workforce diversity and inclusion can benefit from an improvement in revenues and market share over the medium to long term. As the U.S. population—the major consumer base for this industry—undergoes a demographic shift, greater workforce diversity to reflect this shift can help position companies in the industry to capitalize on new consumer trends. The probability and magnitude of impacts on revenues could therefore increase in the future as this demographic shift takes shape.

An inclusive workforce that provides equal opportunities for all employees, including company leaders, can also help companies minimize the risk of lawsuits and related contingent liabilities. It can reduce negative publicity and reputational damage associated with discrimination.

Being able to compare the percentage of gender and racial/ethnic groups represented in both management and lower positions gives an analyst insight into how well a company is positioned to capture revenue growth and market share from improving its understanding of the needs and preferences of current and potential consumer market segments. Conversely, if a company's numbers are far skewed toward a particular gender, ethnic group, or other community, it could also be an indication of future legal risks.

The amount of fines relating to discriminatory practices is a lagging indicator of a company's culture and approach to diversity.

Fair Labor Practices

The retail industry employs more than 15.7 million people.[119] This is roughly 10 percent of the entire U.S. labor force.[120] The most common positions, both in the industry and in the general U.S. labor force, are cashiers and salespeople. Walmart alone employs about 10 percent of all retail workers, or 1 percent of the American workforce. Retail's importance to the U.S. economy means that it is also often at the center of labor practice discussions and "fair wage" arguments. This can have serious reputational implications for companies in the industry whose performance on labor relations is poor.[121] Furthermore, if regulatory changes raise the minimum wage, there would be significant cost implications for companies in this industry.

This is a consumer-facing industry, with consumers regularly interacting with employees directly. Companies could face a decrease in market share and revenue from negative consumer sentiment due to public disagreement between companies and their workers, as well as potential impacts on the quality of customer service from a dissatisfied workforce.

Companies must walk a fine line in making hiring and wage decisions. On the one hand, wages and headcount are variables that management can directly control to manage costs.[122] On the other hand, as highlighted in the following Evidence section, understaffing can result in revenue loss, as under-stocked shelves depress sales, and can also open companies to litigation risk involving illegal labor practices. Managers sometimes resort to practices such as denying employees their state-mandated breaks to counterbalance their lack of workers.

Furthermore, the industry's low average wages, which help companies maintain low prices on products, have led to well-publicized worker protests. These have caused companies to experience negative consumer sentiment and loss of market share due to interest from the press and the public in these issues. Low wages in the industry, coupled with traditionally low unionization rates, has increased interest among retail workers in unionization in recent years. Unions, given their bargaining power, can protect worker rights and negotiate better wages. The NLRB decision to allow for micro-unions, or unions that consist of only one department of a larger department store, has given strength to unions' organizing efforts.[123] Proper management and communication around issues such as worker pay and working conditions can prevent conflicts with workers that could lead to strikes, which can severely impact revenue and create reputational risk.

The retail industry also has one of the highest levels of employee turnover among lower-level employees. This is at least partially due to relatively low wages and occasions of poor labor practices. Higher turnover can result in additional costs of recruitment and training programs. Better management of these issues could lower turnover and, as a result, improve workforce productivity.

Companies can adopt strategies to treat their workforce as a key asset to support long-term growth. This can help to reduce the potential for lost revenue from stores operating at less than full capacity or from facing disruptions from labor actions. Companies can also implement dedicated training for store managers on U.S. labor laws so that they do not open themselves up to the unnecessary risk of labor violations. Ultimately, despite potential short-term cost challenges, companies in this industry that are able to ensure fair working conditions and wages will be better positioned to turn a headline risk into an opportunity and to limit regulatory liabilities.

Company performance in this area can be analyzed in a cost-beneficial way internally and externally through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Average hourly wage and percentage of in-store employees earning minimum wage, by region;
- (1) Voluntary and (2) involuntary employee turnover rate for in-store employees; and
- Amount of legal and regulatory fines and settlements associated with labor law violations.

Evidence

Wages are a large percentage of costs in this industry. Keeping wages low is a strategy that companies employ to protect their profit margins in the face of rising prices in other areas of operation. In 2014, wages represented 13 percent of total revenue for department stores,[124] 9.5 percent for dollar stores,[125] and 8.7 percent for warehouse clubs and superstores.[126] If, as mentioned earlier in the Legislative and Regulatory Trends section, the federal minimum wage is increased, it would put pressure on the margins of companies in this industry. At the same time, however, by providing higher wages, retailers could benefit from higher sales due to the increase in wages of their low-income customers. Higher wages and other fair labor practices could also ensure greater worker satisfaction, which can result in improved productivity and quality of customer service.

Low and stagnant wages at some companies in this industry have led to worker protests and attempts to unionize. The average retail worker not in a supervisory role, which accounts for roughly 86 percent of employees, earns an average of $14.02 an hour. According to calculations by the Economic Policy Institute, when adjusted for inflation, this constitutes a 12.2 percent decrease from the average hourly wage for the same position in 1979.[127] Moreover, the median hourly wage for a retail worker is only 65 percent of the median hourly wage for all U.S. workers.[128]

The retail sector has a very low rate of unionization, at 4.9 percent in 2011, compared with 11.8 percent for all workers in the U.S. In 2013, among full-time wage and salary workers, retail union members made 5 percent more per week than non-union members.[129] The low unionization numbers and relatively low wages in the industry have led to renewed efforts by unions to increase their membership in the retail trade. These actions, especially in a field so visible to the average consumer, are creating negative public perceptions of the relationship between some companies' workers and their management. Increased interest in unionization among retail workers has been met with opposition by both individual companies and the NRF because of the belief that aggressive union-recruitment tactics unfairly undermine their business and do not allow employers to present their own case to their employees.[130] Better management of wages and working conditions, which goes hand in hand with a company culture that promotes communication between management and workers, can help companies diffuse some of these tensions, improve their reputation, and reduce their headline risk.

In 2013, on Black Friday—typically the largest retail day of the year in the U.S.—an unprecedented 1,500 protests against Walmart's low wages received a high level of media coverage.[131] Walmart is currently embroiled in a legal battle with the NLRB over allegations that it illegally retaliated against workers in these and similar wage-related strikes.[132]

These types of public battles can have detrimental effects on a company's value. Walmart's stock price fell by roughly 20 percent between 2000 and 2005; analysts attributed part of this decline to investors' worry about Walmart's image as its labor practices came under greater public scrutiny.[133] This sentiment was given more tangible validity in a 2004 McKinsey report, which found that 2 to 8 percent of Walmart consumers stopped shopping with the company after hearing about its "negative press."[134] Walmart executives and Wall Street analysts began referring to the problem as "headline risk."[135] Such sentiments can also result in divestment actions by major investors. In 2013, the largest Swedish pension fund, AP Funds, which has $145 billion in assets under management, pulled its investments from Walmart because of what it perceived to be poor labor practices.[136]

Consumer sentiment in relation to labor practices and wages can influence retail industry revenues and market share. In a 2014 Ernst and Young survey of U.S. shoppers, 37 percent of respondents said that a firm's reputation for paying fair wages was an important factor in choosing which retail store to patronize.[137] A 2014 consumer survey by Lake Research Partners found that among Walmart's most loyal customers, defined as those who shopped there every week, 9 percent said that they had been shopping there less, and 25 percent of that sub-group said that their decision was based on a perception of poor treatment of workers.[138]

Partially to combat these consumer and investor sentiments, as well as pre-empt government action around a minimum-wage raise, Walmart announced in 2015 that it would first increase its minimum wage to $9 in April 2015, and then to

$10 in February 2016. Other positions would see significant pay raises as well. These raises, along with a higher budget for training, will cost Walmart roughly $1 billion, cutting earnings per share by 24 cents in 2015.[139] Through this announcement Walmart gained positive press, and these actions will potentially lower its employee turnover rate moving forward. Higher wages will likely create more motivated workers, which will result in greater operational efficiency and more satisfied customers.[140] It will also likely increase Walmart's revenue, as many employees spend a significant amount of their paycheck at Walmart.[141] This move has prompted a similar response from its competitors like Target, and it may incite more companies to increase investments in their employees in the near future to continue to attract and retain talent.[142]

The retail industry has a very high rate of employee turnover, especially among its entry-level and part-time employees, where the median rate is 67 percent. Twenty-six percent of retailers find that turnover rates have been increasing as employees seek career paths with greater possibility for advancement and higher pay.[143] This represents a significant cost to the industry; a report by the Center for American Progress found that the cost of finding a replacement for an entry-level worker (categorized as someone making less than $30,000 a year) and training the replacement was about 16.1 percent of the employee's annual salary.[144] Therefore, companies can lower these costs by reducing turnover through ensuring favorable working conditions for their employees.[145]

In addition to wage-related disputes, understaffing has also created problems in the retail industry. In response to the industry's low margins, companies sometimes cut staff to lower payroll costs in order to buffer against losses or gain an advantage over competitors. However, understaffing has led to an increase in employee lawsuits about "stolen wages"[146] as store managers increase productivity targets.[147]

In 2013, for example, Best Buy was ordered to pay $902,000 to employees who were made to clock out and then wait for a physical security check before they could leave work.[148] Dollar Tree is currently in the midst of a class action lawsuit involving more than 4,000 employees who claim that they were forced to continue working after clocking out.[149] Dollar General is facing a similar class action lawsuit alleging that it forced employees to work during mandatory break periods.[150] Dollar General acknowledges these types of lawsuits as an increasing trend and potential financial risk in its FY2014 Form 10-K.[151] In December 2014, the Pennsylvania Supreme Court ordered Walmart to pay $188 million to employees who claimed that they were not adequately compensated for their rest breaks. This lowered the company's fourth-quarter profits by roughly 4 percent. Walmart has said that it will appeal to the Supreme Court.[152]

Not only do these practices resulting from understaffing raise the risk of the aforementioned lawsuits, but understaffing can also lower sales if frustrated customers cannot find, and therefore purchase, goods. Since the recession, companies like Walmart have been reducing the number of employees in their stores to cut costs. Between 2008 and 2013, Walmart added 455 U.S. stores while cutting 1.4 percent of its workforce.[153] Interestingly, Walmart executives stated that there was a $3 billion opportunity in having a larger workforce, because the company was missing sales opportunities by not having all its shelves properly stocked.[154] Indeed, a 2014 Lake Research Partners survey found that 45 percent of loyal Walmart shoppers cited long lines as a reason they have been shopping there less, with 28 percent reporting specifically that their shopping decrease was due to understaffing.[155]

Value Impact

Employers must balance the need to keep payroll costs low, to be able to offer competitive prices, with mitigating the costs of workplace disruptions, litigation, and employee turnover that can come from overworking employees and not offering competitive wages.

Companies that manage this risk well can decrease their total costs over the medium to long term and garner positive consumer sentiment. Together with lower risk of ineffectively stocking goods and higher worker productivity, this would allow companies to gain market share and raise their revenue while protecting brand reputation. Failure to ensure fair labor practices can create "headline risk" and increase the potential for costly lawsuits or operational disruptions, resulting in a higher cost of capital.

Insight into the average hourly wage and percentage of employees earning minimum wage can show analysts how much relative risk companies face from regulatory and other pressures to raise wages. Furthermore, this can highlight a company's risk related to high turnover and low worker productivity. The ability to compare the voluntary and involuntary employee turnover of companies can give insight into a company's culture, workforce management decisions, and employee satisfaction, which are tied to employee productivity. The turnover rate can also give insight into the potential for headline risks. The amount of fines related to labor law violations is a lagging indicator of a company's culture and performance related to fair labor practices.

LEADERSHIP AND GOVERNANCE

As applied to sustainability, governance involves the management of issues that are inherent to the business model or common practice in the industry and are in potential conflict with the interest of broader stakeholder groups (government, community, customers, and employees). They therefore create a potential liability, or worse, a limitation or removal of license to operate. This includes regulatory compliance, lobbying, and political contributions. It also includes risk management, safety management, supply chain and resource management, conflict of interest, anti-competitive behavior, and corruption and bribery.

In the Multiline and Specialty Retailers & Distributors industry, companies can work with their supply chains to anticipate market trends and help ensure that they have the desired products available. The sheer size and market power of many companies in this industry have meant that they have played, and will continue to play, an important role in guiding manufacturers toward responding to consumer demands for sustainable products and packaging.

Product Sourcing, Packaging, and Marketing

Companies in this industry sell a wide array of products, including electronics, groceries, furnishings, and personal care items, all of which have varying environmental and social impacts throughout their lifecycles. Similar products can have divergent health impacts (e.g., two shampoos can have similar effects, but one can contain a potentially harmful chemical and the other not), and different environmental impacts (e.g., two televisions can use a varying amount of electricity to complete the same task). In such cases, many consumers would prefer (even potentially at a price premium) the product that they suspect to be healthier or that results in a lower electricity bill (as well as a lower environmental impact). There are many well-recognized certifications (e.g., U.S. Department of Agriculture Certified Organic and Energy Star) that convey these characteristics to consumers, which retailers can advertise in their stores.

The size and subsequent buying power of many companies in this industry allow them to work effectively with their suppliers on issues like the sourcing of products with low lifecycle environmental and social impacts, sustainable packaging (e.g., lightweighting), and supplier operational efficiency. This is becoming more important with increasing consumer awareness and concern about the environmental and social impacts of the products they purchase. Companies can lower their costs and potentially increase their margins from the resulting efficiencies, as well as advertise these characteristics to their customers to gain market share. Smaller companies in this industry, while often unable to be the first movers in demanding high-level shifts in manufacturing processes, can still work with their suppliers to gain similar terms once a new industry standard has been set. Companies that have private-label products can generally have more control over these operational elements.

Company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics (see Appendix III for metrics with their full detail):

- Revenue from products third-party certified to environmental and/or social sustainability standards;
- Description of processes to assess and manage risks and/or hazards associated with chemicals in products; and
- Description of strategies to reduce the environmental impact of packaging.

Evidence

Many companies in this industry are making serious efforts to address changing consumer preferences around environmental, health, and social issues related to the products they stock. A 2014 Nielsen study found that 42 percent of North Americans were willing to pay more for products that had positive social and environmental impacts.[156] Staples disclosed that it generated roughly $4.2 billion in revenue from products with a third-party environmental certification in 2014.[157]

Amid growing consumer concerns over the safety of household and personal care products, Walmart in 2014 developed a list of 10 substances that it will no longer allow in these products, although they have not yet released this list to the public.[158] Furthermore, Walmart is requiring companies that sell these items at their stores to disclose their chemical components.[159] Target[160] and Bed Bath & Beyond[161] have announced similar programs to help assuage growing consumer fears about potentially harmful chemicals in their cosmetic and household products.[162]

Home Depot and Lowe's, which, combined, account for 82.9 percent of the domestic home-improvement store market,[163] have told their suppliers that they have a preference for sustainably sourced wood certified by the Forest Stewardship Council (FSC).[164] As there is currently not enough supply of sustainable wood to meet demand, this is a tacit agreement by these major companies to purchase any FSC-certified wood that companies can produce. This encourages their suppliers to produce this more expensive yet more sustainable products, which benefits both the home improvement companies and their suppliers. FSC-certified wood fulfills the requirement for the LEED-certified[VII] wood credit,[165] the demand for which is expected to increase.[166] This also helps companies lower their overall risk profile, as the sustainable management of forests could help temper the already volatile price of lumber in the long term.[167] Staples estimates $590 million in sales of FSC-certified products in 2014, a 32 percent increase from 2012.[168]

In another product category, Home Depot and BJ's Wholesale Club, among other retailers, have started requiring suppliers to label the pesticides used on any plants sold in their stores. This stemmed from a myriad of studies, including by the U.S. Department of Agriculture, showing that certain pesticides were causing a precipitous drop in the honeybee population, which is integral to the U.S. agriculture industry.[169]

To gain market share and increase revenues, companies in this industry have been promoting the cost-saving potential of sustainable and energy-efficient products to consumers. As Costco discloses in its FY2014 Form 10-K, "Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to timely identify or effectively respond to changing consumer tastes, preferences *(including those relating to sustainability of product sources)* and spending patterns could negatively affect our relationship with our members, the demand for our products and services and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns and reduce our operating performance. This could have an adverse effect on margins (net sales less merchandise costs) and operating income."[170] (Emphasis added.)

Best Buy says that its consumer education involving Energy Star and EPEAT[VIII] products is "virtually certain"[171] to drive an increase in demand for its products. The company claims to have sold nearly 7 million units of its EPEAT-qualified products in FY2015 alone, equates to the amount of energy used by 15,000 houses per year.[172] In its FY2015 Form 10-K, Best Buy also discloses that "Best Buy's U.S. customers purchased more than 25 million Energy Star certified products in fiscal 2015 and realized utility bill savings of more than $71 million. These energy savings equate to over 900 million pounds of CO_2 avoidance, or the equivalent of removing more than 86,000 cars from U.S. roads."[173]

Home Depot, in its FY2015 Form 10-K, states that it sold 20 million Energy Star products, which, it calculated, saved its consumers $630 million on their energy bills.[174] Home Depot also calculated that the sale of Water Sense[IX] products saved customers $400 million on their water bills in 2014 alone.[175] The company also has an "Eco-Options" program, started in 2007, which highlights more than 9,000 of its products that "meet specifications for energy efficiency, water conservation, healthy home, clean air and sustainable forestry."[176] Prominent marketing of use-phase energy and cost-savings benefits can help convince consumers to buy what are generally more expensive products, thereby increasing companies' revenue.

[VII] The U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) rating system encourages the design and construction of buildings that are environmentally friendly, as well as safer, for their occupants.

[VIII] Electronic Product Environmental Assessment Tool, a sustainable electronics program of the U.S. Environmental Protection Agency (EPA)

[IX] EPA program focused on water-efficient products

Walmart instituted a sustainability scorecard in 2007 for the packaging of products that it sells in its stores.[177] Its purpose was to encourage its suppliers to create more sustainable packaging, as well as to create a framework for its buyers to consider sustainable packaging as an important component of their purchase decision.[178]

Lightweighting and size optimization of packaging can lower companies' costs of shipping goods from their distribution centers to their stores or to their customers. Less packaging also can decrease the cost of the good, which can mean a lower cost for the retailer, as well as allowing more goods to be placed on retail shelves. A mandated 5 percent reduction in packaging across all product categories from 2008 levels saves Walmart an estimated $3.4 billion annually through lower shipping and material costs.[179] Target has made a commitment to a 10 percent decrease in the amount of packaging material or packaging waste generated, or a 10 percent increase in the amount of recycled packaging, in 50 of its private-label products between FY2011 and FY2016.[180] Along with the improved energy efficiency of transporting goods, the more efficient and sustainable use of containers and packaging materials has profound sustainability implications, as roughly one-third of all consumer trash in landfills is packaging.[181]

An Accenture study estimates that green packaging initiatives can save retailers between 3 to 5 percent of their packaging and shipping costs.[182] Furthermore, a recent survey by the packaging company Tetra Pak found that 37 percent of respondents said that they looked for environmental logos on packaging when making their purchasing decisions.[183] Besides the cost implications, therefore, efforts like this can gain companies a reputation for sustainability, allowing them to reach the growing consumer base[184] for green products and increase their market share.

Besides packaging initiatives and product sustainability characteristics, retailers may also be able to influence supplier manufacturing practices. Many of these companies, which have large budgets and efficient management systems, can pass on relevant knowledge to their suppliers for mutual gain. Since 2008, for example, Walmart has worked with 210 of its Chinese supplier factories and has helped them achieve a 20 percent reduction in energy use. This effort has resulted in $279 million in energy cost savings for the suppliers, an undisclosed amount of which has been passed on to Walmart.[185] Companies that have private-label products can have greater control over the operational efficiency, quality, and sustainability characteristics of these elements of their supply chain.

There is investor interest in the performance of retailers on this issue. The New York State comptroller filed shareholder resolutions with both Bed Bath & Beyond and Best Buy in 2013, asking them to require suppliers with whom they did more than $1 million in business to submit sustainability reports, as well for the companies to detail their responses to suppliers' non-compliance with international environmental and social sustainability standards. Both filings were withdrawn as the companies agreed to address the issues.[186]

Value Impact

Companies in this industry that collaborate with suppliers to create, source, and market sustainable products can realize cost savings, capitalize on consumer trends, and differentiate themselves from their competition. These actions can help companies gain market share from improved brand reputation and demand for the products they sell and for their services, and increase their revenue, especially as sustainable products tend to be priced higher. Being able to predict consumer trends around sustainable products can also cut down on company margin losses from excess inventory.

Furthermore, companies can reduce operating costs through the more efficient use of packaging materials and through lightweighting of packaging, which can lower their shipping costs. Companies with an ability to influence supplier manufacturing practices may also be able to obtain lower-priced goods because of the cost savings from more energy-efficient or otherwise sustainable supplier operations.

The revenue from products meeting environmental and social sustainability standards as well as the percentage of household, personal care, and home products with public disclosure of chemicals ingredients indicate relatively how much a company is able to capitalize on growing consumer concerns over the safety and environmental impact of the products they use. A discussion of its process to identify and manage emerging materials of concern indicates a company's preparedness to respond to advancing scientific knowledge and evolving regulations on the issue of chemical safety and pre-empt negative consumer sentiment. Understanding a company's packaging strategy provides insight into its efficiency in this cost center and whether there is potential for further savings.

SASB INDUSTRY WATCH LIST

The following section provides a brief description of sustainability disclosure topics that are not likely to constitute material information at present but could do so in the future.

Data Privacy: Companies in the Multiline and Specialty Retailers & Distributors industry are using increasingly sophisticated methods of tracking and analyzing consumer demographic information and purchasing behavior to create personalized advertisements and to determine what products to stock. Well-publicized incidents—such as the 2012 incident in which a Target advertising algorithm discerned that a girl was pregnant before her father did—spark public debate about the ethical use of consumer data.[187]

A study conducted by McCann Truth Central found that 70 percent of consumers surveyed worldwide were concerned about the erosion of personal privacy,[188] and a 2013 JD Power and Associates survey found that 81 percent of consumers felt that they had lost all control over how their data was collected and used by companies.[189] Companies will have to strike a careful balance between the increased revenue that more intelligent advertising can bring and the potential for consumer backlash and a subsequent loss of market share for companies that are perceived to abuse consumer information.

While some companies in the industry are using customer data for targeted advertising, the industry as a whole has yet to begin using data in the same sophisticated way and to the same extent as companies in the Internet, software, and e-commerce industries. Risks from data privacy issues are likely to increase over time as the Multiline and Specialty Retailers & Distributors industry further integrates with the online shopping experience; therefore, this issue could constitute material information for companies in the future.

APPENDIX I

FIVE REPRESENTATIVE MULTILINE AND SPECIALITY RETAILERS & DISTRIBUTORS COMPANIES[X]

COMPANY NAME (TICKER SYMBOL)
Walmart Stores Inc. (WMT)
Costco Wholesale (COST)
Home Depot (HD)
Target Corp. (TGT)
Macy's Inc. (M)

[X] This list includes five companies representative of the Multiline and Specialty Retailers & Distributors industry and its activities. This includes only companies for which the Multiline and Specialty Retailers & Distributors industry is the primary industry, that are U.S.-listed but are not primarily traded over the counter, and for which at least 20 percent of revenue is generated by activities in this industry, according to the latest information available on Bloomberg Professional Services. Retrieved on July 1, 2015.

APPENDIX IIA:
Evidence for Sustainability Disclosure Topics

Sustainability Disclosure Topics	EVIDENCE OF INTEREST				EVIDENCE OF FINANCIAL IMPACT				FORWARD-LOOKING IMPACT		
	HM (1-100)	IWGs		EI	Revenue & Cost	Asset & Liabilities	Cost of Capital	EFI	Probability & Magnitude	Exter-nalities	FLI
		%	Priority								
Energy Management in Retail & Distribution	85*	80	4	High	•		•	Medium	•		Yes
Data Security	70*	90	2	High	•	•	•	High	•		Yes
Workforce Diversity & Inclusion	65*	90	5	High	•	•		Medium	•		Yes
Fair Labor Practices	73*	100	3	High	•	•	•	High			No
Product Sourcing, Packaging, and Marketing	68*	90	1	High	•	•		High			No

HM: Heat Map, a score out of 100 indicating the relative importance of the topic among SASB's initial list of 43 generic sustainability issues; asterisks indicate "top issues." The score is based on the frequency of relevant keywords in documents (i.e., 10-Ks, 20-Fs, shareholder resolutions, legal news, news articles, and corporate sustainability reports) that are available on the Bloomberg terminal for the industry's publicly-listed companies; issues for which keyword frequency is in the top quartile are "top issues."

IWGs: SASB Industry Working Groups

%: The percentage of IWG participants that found the disclosure topic to likely constitute material information for companies in the industry. (-) denotes that the issue was added after the IWG was convened.

Priority: Average ranking of the issue in terms of importance. One denotes the most important issue. (-) denotes that the issue was added after the IWG was convened.

EI: Evidence of Interest, a subjective assessment based on quantitative and qualitative findings.

EFI: Evidence of Financial Impact, a subjective assessment based on quantitative and qualitative findings.

FLI: Forward Looking Impact, a subjective assessment on the presence of a material forward-looking impact.

APPENDIX IIB:
Evidence of Financial Impact for Sustainability Disclosure Topics

Evidence of Financial Impact	REVENUE & EXPENSES							ASSETS & LIABILITIES				RISK PROFILE	
	Revenue			*Operating Expenses*		*Non-operating Expenses*		*Assets*		*Liabilities*		*Cost of Capital*	*Industry Divestment Risk*
	Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extra-ordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities		
Energy Management in Retail & Distribution	• (Medium)			• (High)		• (Medium)						• (Medium)	
Data Security	• (High)			• (Medium)		• (Medium)	• (High)		• (High)	• (High)		• (High)	
Workforce Diversity & Inclusion	• (Medium)						• (Medium)		• (Medium)	• (Medium)			
Fair Labor Practices	• (Medium)			• (High)			• (Medium)		• (High)	• (Medium)		• (Medium)	
Product Sourcing, Packaging, and Marketing	• (High)	• (Medium)	• (Medium)	• (High)				• (Medium)	• (Medium)				

MEDIUM IMPACT HIGH IMPACT

APPENDIX III: Sustainability Accounting Metrics | Multiline and Specialty Retailers & Distributors

TOPIC	ACCOUNTING METRIC	CATEGORY	UNIT OF MEASURE	CODE
Energy Management in Retail & Distribution	Total energy consumed, percentage grid electricity, percentage renewable energy	Quantitative	Gigajoules (GJ), Percentage (%)	CN0403-01
Data Security	Discussion of management approach to identifying and addressing data security risks	Discussion and Analysis	n/a	CN0403-02
	Number of data security breaches, percentage involving customers' personally identifiable information (PII), number of customers affected*	Quantitative	Number, Percentage (%)	CN0403-03
Workforce Diversity & Inclusion	Percentage of gender and racial/ethnic group representation for (1) management and (2) all other employees	Quantitative	Percentage (%)	CN0403-04
	Amount of legal and regulatory fines and settlements associated with employment discrimination**	Quantitative	U.S. Dollars ($)	CN0403-05
Fair Labor Practices	Average hourly wage and percentage of in-store employees earning minimum wage, by region	Quantitative	U.S. Dollars ($), Percentage (%)	CN0403-06
	(1) Voluntary and (2) involuntary employee turnover rate for in-store employees	Quantitative	Rate	CN0403-07
	Amount of legal and regulatory fines and settlements associated with labor law violations***	Quantitative	U.S. Dollars ($)	CN0403-08
Product Sourcing, Packaging, and Marketing	Revenue from products third-party certified to environmental and/or social sustainability standards	Quantitative	U.S. Dollars ($)	CN0403-09
	Description of processes to assess and manage risks and/or hazards associated with chemicals in products	Discussion and Analysis	n/a	CN0403-10
	Description of strategies to reduce the environmental impact of packaging	Discussion and Analysis	n/a	CN0403-11

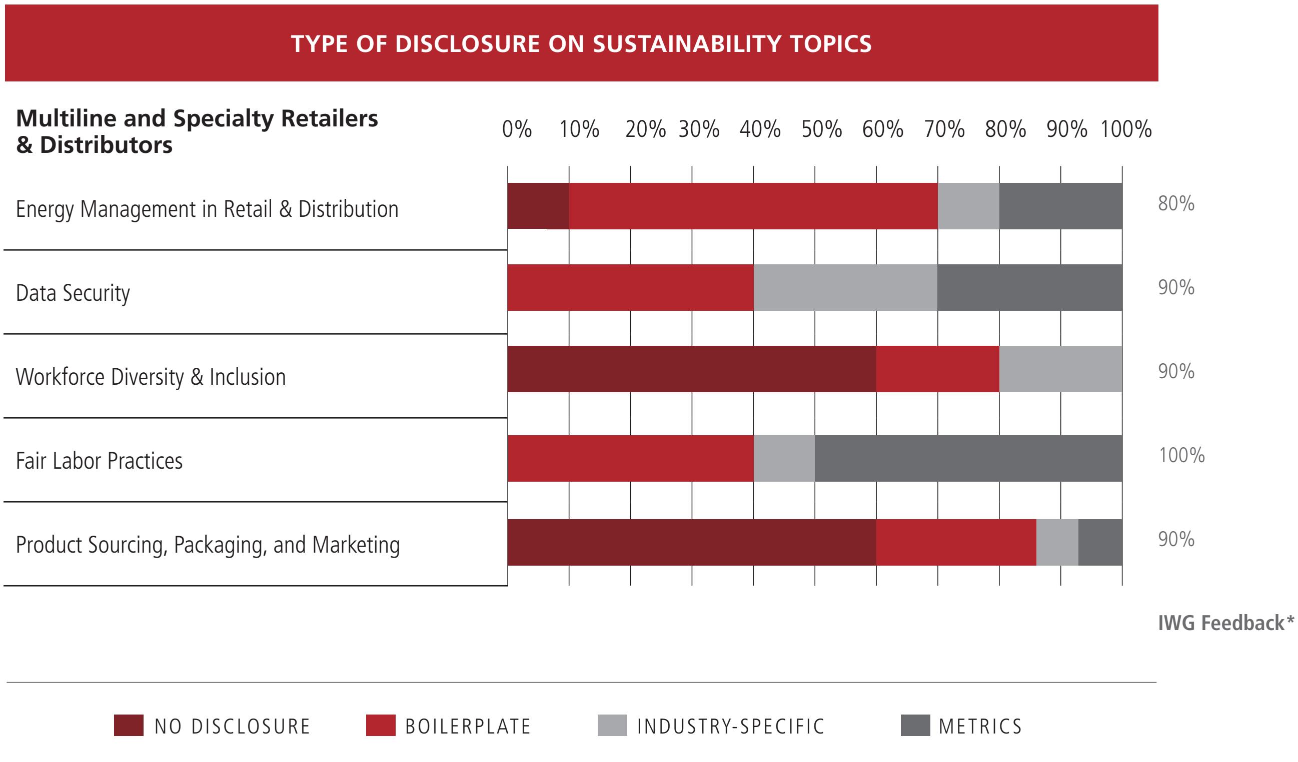
* Note to **CN0403-03**—Disclosure shall include a description of corrective actions implemented in response to data security breaches.

** Note to **CN0403-05**—Disclosure shall include a description of fines and settlements and corrective actions implemented in response to events.

*** Note to **CN0403-08**—Disclosure shall include a description of fines and settlements and corrective actions implemented in response to events.

APPENDIX IV: Analysis of SEC Disclosures | Multiline and Specialty Retailers & Distributors

The following graph demonstrates an aggregate assessment of how representative U.S.-listed Multiline and Specialty Retailers & Distributors companies are currently reporting on sustainability topics in their SEC annual filings.



*Percentage of IWG participants that agreed topic was likely to constitute material information for companies in the industry.

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